

Procedure No. 5-03-06A

COMPLIANCE REVIEW GUIDELINES

Background

Few performance audits are of the compliance type; however, most audits involve limited evaluations of agency compliance with applicable laws and regulations that affect specific programs under audit.

The following procedures are designed to provide a formalized approach to auditing for compliance. These procedures should be implemented during the preliminary survey stage of the audit and should, in part, determine the overall audit scope. Noncompliance may result in the development of substantial audit findings. Determining compliance with applicable laws and regulations is basically a four-step process. The four steps are: (1) identifying applicable laws and regulations; (2) questioning responsible personnel in the entity being audited as to whether or not the entity is complying with the laws and regulations; (3) verifying the answers given during the compliance questioning session; and (4) documenting the compliance review.

Identifying Applicable Laws and Regulations

To identify applicable laws and regulations, the auditor must obtain and review the laws and regulations that pertain to a particular agency or program. When reviewing for compliance, the auditor should concentrate on those code sections or regulations that impose a burden on the audited entity to either do something or to be assured that something is done. These code sections or regulations can usually be identified in that they (1) state that the audited entity shall or must do something as opposed to may do something, or (2) require the entity to establish procedures and/or systems to assess whether or not something is being done.

The distinction between a “shall” type and a “may” type code section or regulation is critical to a compliance audit in that “shall” is not discretionary whereas “may” is. In other words, an entity is required to comply with a “shall” type code section or regulation but not a “may” type code section or regulation. In addition, a “shall” type code section is a clearer statement of legislative intent than a “may” type code section and, as such, provides a definite criteria against which to measure compliance by the audited entity.

Questioning Responsible Personnel in the Entity Being Audited

Once the auditor has identified the appropriate laws and regulations, the next step is to question responsible personnel in the entity being audited as to whether or not the entity is complying with those laws and regulations. As a general rule, “responsible personnel” means as high an official within the audited entity as possible or practical, given that it may take an entire day or longer to complete a full compliance questioning

session. It is important that the auditor properly plan the compliance questioning session so that it can be completed as rapidly and efficiently, yet thoroughly as possible with a minimum of disruption to the personnel of the audited entity. The auditor should, however, encourage the personnel interviewed to make comments and observations in addition to merely responding “yes” or “no” to questions regarding compliance with applicable laws and regulations. This step is especially important in those instances when the interviewee answers “no” to a question regarding compliance. There may be mitigating circumstances that either (1) preclude compliance or (2) make compliance unnecessary or impractical. In either case, the auditor should be aware of these circumstances as soon as possible to avoid the possibility of pursuing an issue of noncompliance that is without substance or materiality.

In those instances of noncompliance where there are no mitigating circumstances, the auditor should discuss the situation with the highest responsible official within the entity being audited to obtain concurrence. When an auditor has identified an instance of noncompliance, that issue should be pursued to determine the cause and effect of such noncompliance.

Verifying the Answers Given During the Compliance Questioning Session

The third step in determining compliance with applicable laws and regulations is verifying the answers given during the compliance questioning session. The auditor must exercise judgment in selecting those answers that are to be verified because in many instances, the answers obtained during the question session will be sufficient and no additional audit work will be necessary. This is particularly true in those instances where noncompliance by the audited entity would be relatively immaterial or insignificant.

The process of verifying answers given during a compliance questioning session involves obtaining evidence to support or refute the answers given. The evidence can be obtained by the following methods: (1) interviewing additional personnel; (2) testing the records, (correspondence, contracts, financial statements, etc.), and procedures of the audited entity; (3) observing the operations and physical assets of the audited entity; and (4) analyzing information and data. The procedures selected to verify compliance answers are a matter of judgment on the part of the auditor. However, regardless of the method selected, the auditor should be satisfied that the answers given during the compliance questioning session are accurate and correct in all material respects.

As a general rule, the two factors that determine the amount of evidence obtained by the auditor to verify compliance answers are (1) the procedures and systems of controls used by the audited entity to ensure the reliability of their management information or other means of demonstrating compliance, and (2) the significance of the compliance area being verified. If the audited entity’s procedures or controls are weak or if the compliance area is significant, then the auditor should obtain more evidence to verify compliance answers than if procedures or controls are adequate or the compliance area relatively insignificant.

Documenting the Compliance Review

The final step in determining compliance with applicable laws and regulations is documenting the compliance review. This step provides a record of what questions were asked by the auditor, what answers and comments were made by the audited entity, and what the auditor did to verify the answers and comments made by the audited entity.

A simple and effective method of documenting the compliance review is to copy the applicable laws and regulations onto a compliance checksheet file. The last column of the checksheet is used to record the responses and comments of the audited entity and the type of procedures the auditor used to verify the responses and comments of the audited entity. This checksheet is a lead schedule and, as such, should be referenced to supporting workpapers as appropriate. The exhibit on 5-03-06B (Compliance Checksheet) illustrates the above procedures.